State of California

ATTACHMENT

The Resources Agency

Memorandum

Date : February 21, 2002

To : Honorable Loretta Lynch, President
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, California 94102

From : **Department of Water Resources**

Subject : California Department of Water Resources Revenue Requirements

The California Department of Water Resources (the Department) has reviewed the comments submitted in connection with the Department's pending revenue requirement. In response to such comments, we have concluded that the adjustments described below can be made to our pending revenue requirement.

On December 6, 2001, we submitted additional data relating to our November 5, 2001 Determination of Revenue Requirement, including a discussion of certain amounts that the Department was to be billed by the California Independent System Operator (ISO) that were not included in the Department's revenue requirement and certain changes to reflect changes from accrual to cash for revenues and expenses ("leads and lags") calculations for 2002.

We did not adjust our revenue requirements to reflect such matters since they did not in the aggregate materially affect our revenue requirement. It was our intention to reflect the impact of such matters in the next revenue requirement. We did so based upon, among other things, uncertainty as to the time and amount of reimbursement for such ISO-related costs. Based upon our review of the published draft order addressing utility retained generation (URG) (Re: A–00-11-038) we now understand that the California Public Utilities Commission (the Commission) is considering requiring the investor owned utilities to reimburse the Department for a portion of such ISO-related costs during the current revenue requirement period. We believe that is the right result.

If the utilities are so ordered and the Department in fact is reimbursed by the utilities for such ISO-related costs by no later than September 1, 2002, then the Department's revenue requirement for this calendar year as submitted November 5, 2001 can be reduced by an amount equal to $609,000,000 representing those leads and lags adjustments. Since the need to include that amount in the revenue requirement has become contingent on the Commission's decision on the ISO-related costs, the Department agrees that its revenue requirement should be contingently reduced by $609,000,000, provided however, that if the Commission does not, by March 22, 2002 order the utilities to reimburse the Department for these ISO related costs, with such

reimbursement to be paid in full on or before September 1, 2002, then the Department's revenue requirement will be automatically adjusted, as of March 22, 2002 to reinstate such $609,000,000. In that event, such amounts will be recovered on such schedule and in such manner as the Commission shall determine in order to allow the Department to recover such costs prior to September 1, 2002.

In calculating its November 5, 2001 revenue requirements the Department also took into account amounts payable as principal and interest on the Department's Interim Loan during the fourth quarter. The Department presently expects to issue bonds for the purpose of repaying such Interim Loan (as well as the General Fund) prior to the time such payments are due. Assuming that this occurs, such payments would not be required. Based upon such expectation and our expectation as to Department expenditures and revenues for the time prior to such payments becoming due, the Department agrees that its revenue requirement should also be contingently reduced by a net amount of $349,000,000, contingent on the sale of the Bonds in advance of the fourth quarter's payments on the Interim Loan. The date on which the Bonds will be sold cannot be determined at this time. In the event that the Bonds are not sold by September 1, 2002, then the revenue requirement for the balance of the current year will again take such principal and interest payments into account and we understand that the charges established by the Commission will be revised by the Commission at such time to reflect the reinstatement of such amount as part of the revenue requirement to the extent necessary to assure that the revenues derived from the Department's charges will be sufficient to provide for all of the Department's revenue requirements as and when due.

These contingent reductions have an effect on the Department's financing projections because of, among other things, the reduced revenues received by the Department prior to the issuance of the bonds. This reduction could result in the need to increase the principal amount of bonds to be issued by as much as $250,000,000 more than the maximum par amount contained in the Summary of Material Terms which we submitted on February 15, 2002. Therefore we are amending the Summary of Material Terms as reflected in Attachment A to this letter. There is only one change in Attachment A: $10,850,000,000 as it appears in paragraph "I" is increased to $11,100,000,000. We note that in accordance with the Summary, the Department will issue no more Bonds than it determines are necessary to repay advances from the General Fund and the Interim Loan, to fund the reserves and accounts as described in the Summary and to pay costs of issuance using all Bond proceeds and all Department Electric Power Fund balances available at the time of issuance of the Bonds. Over the next two weeks, we will be consulting with the Commission with a view to avoiding or reducing any increase in the amount of the Bonds and to consider reflecting a reduction in the authorized material terms, if appropriate.

We understand that the adjustments described above can be implemented within existing overall rates.

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We would appreciate these changes being reflected in the decision establishing Department charges in response to our November 5, 2001 revenue requirement submission.

Peter S. Garris
Deputy Director

Attachment

(Attachment Omitted)

(END OF ATTACHMENT)